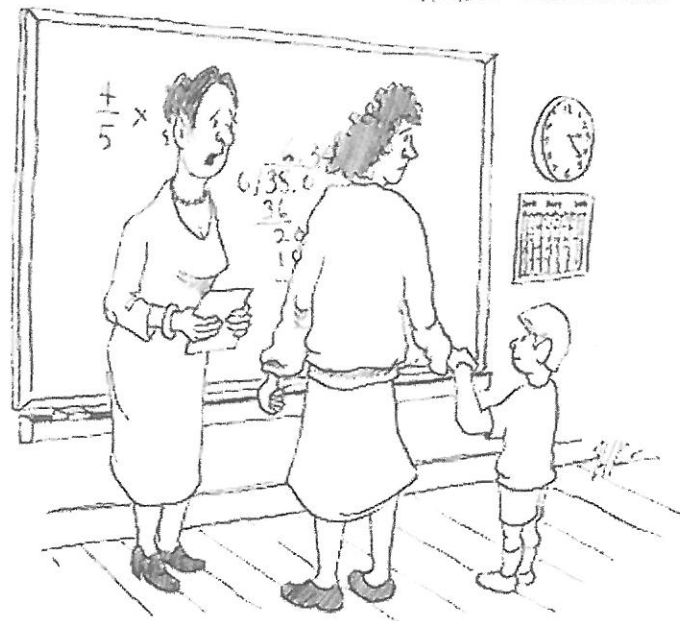


HL / SL IB Economics: The Internal Assessment Guide

Copyright 2008 John Crowther



"Jeremy refuses to study. He says he's going to become an economist and they don't have to know anything."

Contents:

Preface

Part 1

General Introduction

Part 2

Selecting the Article

Appraising and Evaluating the Article

Part 3

Writing the Commentary

Commentary 1

Commentary 2

Commentary 3

Commentary 4

Commentary 5

Commentary 6

Commentary 7

Preface

The aim of this book is to provide advice for the completion of the internal assessment requirement for both higher and standard level economics.

Part 1 sets out the assessment criteria together with practical guidance relating to time allocation, selection of articles and general requirements.

Part 2 provides detailed guidance about how to appraise an article and how to extract and evaluate the content for the commentary.

Part 3 presents actual articles with written commentaries to provide worked examples for the student.

Requirements

You will produce a portfolio of **three*** commentaries of a **maximum of 750 words each**, based on published extracts from the news media. Each article **must** be based on a different section of the syllabus (microeconomics, macroeconomics, international economics, development economics). The extracts should be from a newspaper, and must not be from television or radio broadcasts. You should not choose a blog or a transcript as the basis for your commentary. Each commentary must come from a different source.

*You will in fact write four commentaries of which three will be chosen.

Choosing your article (You must have a different source for each commentary)

Method 1: Google

- Open www.google.com
- Click on the 'News' icon.
- Type in the topic area (e.g. oil price, coffee price, monopoly, patents, steel tariff, . . .)
- Glance through several articles from the list to try to find one that you feel would enable you to define economic terms, apply economic laws, draw relevant economic graphs and evaluate the theories you applied.

Method 2: Search news archives in online newspapers

- Open the website of an English newspaper. Do try to use newspapers from different countries.
- Type in a precise topic area in the search engine/archives on the site.
- Pick from the more recent articles.

The BBC in the UK - <http://news.bbc.co.uk/2/hi/business/default.stm>

The Telegraph in the UK - <http://www.telegraph.co.uk/>

The Globe and Mail in Canada - <http://www.theglobeandmail.com/report-on-business/>

The Age in Australia - <http://www.theage.com.au/>

The Jakarta Post in Indonesia - <http://www.thejakartapost.com/channel/business>

The International Herald Tribune (New York Times international edition) - <http://global.nytimes.com/?iht>

The Washington Post in the US - <http://www.washingtonpost.com>

USA Today in the US - <http://www.usatoday.com/>

The Hindustan Times in India - <http://www.hindustantimes.com/>

The Standard in Kenya - <http://www.standardmedia.co.ke/business/>

The Manila Times in the Philippines - <http://www.manilatimes.net/index.php/business>

Method 3

Go to www.thepaperboy.com. Here you will find an overview of all possible newspapers on the article. Choose a country and then search for newspapers in English. When you choose a newspaper, the site re-directs you to the site where you can look for a suitable article. Ideally, you will choose three articles from three different countries. Please try to widen your search to include different countries.

A Guide to Writing Internal Assessment Commentaries

Layout

Paragraph 1 – summarise article (briefly), using economic terminology.

Paragraph 2 – Theory before any government intervention or change in determinants

Paragraph 3 – Intervention theory – include quotes from the text. Explain impact of intervention using graph(s).

Paragraph 4 – Evaluate the impact of the policy

Paragraph 5 – evaluate and summarise

Criterion A – Diagrams (3 marks)

- Label the axis with the appropriate market (quantity of sugar, price of sugar) as well as a title for the graph (Sugar Market).
- Don't download diagrams.
- Express a shift (no need to just draw the equilibrium diagram)

Criterion B – Terminology (2 marks)

- Define 2 to 4 key terms. These terms should be relevant and used throughout the article.
- Embed the definitions into the text.
- e.g. "the production of heat creates external costs that are damaging to third parties"
- Avoid using "This is defined as..."

Criterion C – Application (2 marks)

- Make reference to the article, quoting relevant parts.

Criterion D - Analysis and Explanations (3 marks)

- Use economic theory
- Explain what has happened in the diagram **and WHY** (cause of the shift **and** effect on price and quantity).

Criterion E – Evaluation (4 marks)

- Evaluate the impact of the policy.
 - Explain the extent to which the change has an impact on price/quantity.
 - Long Run vs. Short Run effects
 - Prioritisation of points, advantages & disadvantages
 - Impact on different stakeholders
 - Elasticity of the 'other' curve

Criterion F - Rubric requirements (3 marks)

- Within word count (750 words)
- Sources are clearly referenced
- Cover sheet is present
- All three articles must come from different sources
- Chose articles that's theme are from different parts of the syllabus (microeconomics, macroeconomics, international economics, development economics)
- The article is a less than 1 year at the time of writing the commentary.

Each commentary must not exceed 750 words. Moderators will not read beyond 750 words).

The following are **not** included in the word count:

- Acknowledgements
- Contents page
- Diagrams
- Labels of five words or fewer
- Headings on diagrams of 10 words or fewer
- Tables of statistical data
- Equations, formulae and calculations
- Citations or references (which, if used, must be in the body of the commentary)

Each commentary must have a **cover sheet** that includes the following required information:

- the title of the article
- the source of the extract (Including date of access to the internet site)
- the date the article was published
- the date the commentary was written
- the word count of the commentary
- the section(s) of the syllabus to which the commentary relates.

Along with the cover sheet for each commentary, you will be given a summary portfolio cover sheet for the final portfolio. When the final portfolio is assembled, it will include the summary portfolio cover sheet, three commentary cover sheets, three articles and three commentaries.

Discussion and support

It is a good idea to discuss the work you are doing for the portfolio with your teacher, and to seek advice and information. You will not be penalized for seeking guidance!

Advice

As part of the learning process, your teacher can give you advice on a first draft of each portfolio commentary. This advice can be either verbal or written and will suggest how the work could be improved. However, your teacher is not allowed to extensively annotate or edit your draft. You may rewrite your commentary in line with your teacher's suggestions but your teacher may not advise you on more than one draft.

Internal Assessment Criteria

There are five internal assessment criteria that will be assessed for each commentary.

Criterion A	Diagrams	3 marks
Criterion B	Terminology	2 marks
Criterion C	Application	2 marks
Criterion D	Analysis	3 marks
Criterion E	Evaluation	4 marks
	Total	14 marks x 3 commentaries = 42 marks

There is one internal assessment criterion for the whole portfolio.

Criterion F	Rubric requirements	3 marks
-------------	---------------------	---------

Each commentary is assessed individually for the first five assessment criteria (criteria A – E) and then criterion F is applied to the whole portfolio. Thus, the total points available are 45 (14 X 3 = 42 + 3= 45)

Criterion A: Diagrams

This criterion assesses the extent to which the student is able to construct and use diagrams.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	Relevant diagrams are included but not explained, or the explanations are incorrect.
2	Relevant, accurate and correctly labelled diagrams are included, with a limited explanation.
3	Relevant, accurate and correctly labelled diagrams are included, with a full explanation.

Criterion B: Terminology

This criterion assesses the extent to which the student uses appropriate economic terminology.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	Terminology relevant to the article is included in the commentary.
2	Terminology relevant to the article is used appropriately throughout the commentary.

Criterion C: Application

This criterion assesses the extent to which the student recognises, understands and applies economic information in the context of the article.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	Relevant economic concepts and/or theories are applied to the article.
2	Relevant economic concepts and/or theories are applied to the article appropriately throughout the commentary.

Criterion D: Analysis

This criterion assesses the extent to which the student can explain and develop appropriate economic theories and/or concepts in the context of the article.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	There is limited economic analysis relating to the article.
2	There is appropriate economic analysis relating to the article.
3	There is effective economic analysis relating to the article.

Criterion E: Evaluation

This criterion assesses the extent to which the student synthesises his or her analysis in order to make judgments that are supported by reasoned arguments.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	Judgments are made that are unsupported, or supported by incorrect reasoning.
2	Judgments are made that are supported by limited reasoning.
3	Judgments are made that are supported by appropriate reasoning.
4	Judgements are made that are supported by effective and balanced reasoning.

Criterion F: Rubric requirements

This criterion assesses the extent to which the student meets the five rubric requirements for the complete portfolio.

- Each commentary does not exceed 750 words
- Each article is based on a different section of the syllabus.
- Each article is taken from a different and appropriate source.
- Each article was published no earlier than one year prior to the writing of the commentary.
- The summary portfolio cover sheet, three commentary cover sheets and the article for each commentary are included.

Level	Descriptor
0	The work does not reach a standard described by the descriptors below.
1	Three rubric requirements are met.
2	Four rubric requirements are met.
3	All five rubric requirements are met.

Frequently Asked Questions

What type of stimulus material should I use as extracts for the commentaries?

The extracts should be from a newspaper. You should not use a blog for your source. You are advised not to choose articles from *The Economist* magazine, since the economic analysis will have already been done, leaving you with little to add. Articles from magazines tend to be too long. If you find an article from *Reuters* or *Yahoo News*, please look a little longer to find the article in an actual newspaper, as these are not exactly newspapers.

Which web sites are appropriate for extract selection?

Newspaper web sites are the only appropriate sources.

How long should an extract be?

In theory, extracts may be any length. Regardless of the length, you should highlight or underline the specific areas of the extract that you have selected for discussion.

You are advised to choose articles that print on **no more** than one and a half pages in a 12-point font. On page articles are best. You should copy the article into a separate word document in case the article is removed from the internet and to make it easier to print. Be sure to include the name of the publication and the *url* address on the word document.

Can the extract be in any language?

The article or material used for the extract should be written in English. Other languages may be used but you **must** provide an exact translation of the relevant sections.

How much feedback can the teacher give?

Your teacher will set internal deadlines for the submission of the final version of each commentary. These are compulsory deadlines. At this point commentaries will be collected and will not be available for further editing.

How important is it to meet the word limit requirements?

Vitally important! The word limit requirement is **exact**. Each commentary must have a maximum of 750 words.

What does it mean to say "effective use of diagrams" in criterion B level 4?

Any diagram used in a commentary should be explained and should be made relevant to the discussion. Whenever numerical data is provided in an extract, it should be incorporated into the diagram. Ideally, the diagrams will be drawn on the computer. If this is impossible, it is important to draw the diagrams very neatly. The labelling of diagrams must be made specific to the case study discussed in the article. For example, if the article is about the rising price of pecans in the US, then the y-axis label should be "Price of pecans, US\$ per kilo) and the x-axis label should be 'Quantity of pecans per time period ('000s of kilos)'

Evaluation

What does it mean to evaluate economic theories in the context of real-world examples in criterion E?

Evaluation implies a judgment of a theory and an application of the theory to a given situation, with some critical awareness. Evaluation can be done in different ways, but there are several hints. Evaluation may be carried out whenever you do any of the following, **coming to a reasoned conclusion**.

The following offers some suggestions as to how you might show evidence of evaluation in your work:

- Identify which factor is the most important in a list of reasons, costs, benefits, etc. and then justify your choice. For example, *“according to the article, the most important cost of inflation is its effect on investment because . . .”*
- Compare and contrast the short term implications with the long-term implications of an event. For example, *“This article considers the short run effects of the increased costs of capital for Canadian firms. However, in the long run, total costs are likely to fall in the long run as a result of the current levels of investment.”*
- Look at an economic ‘event’ or policy from the point of view of different ‘stakeholders and make a judgment about the relative effects. For example, *“There are clearly a number of negative consequences of the reduction in EU subsidies on the British milk farms identified in the article. However, in terms of the global allocation of resources, the effects can be considered positive. Non-EU milk farms will have the opportunity to gain valuable market share. Furthermore, the reduced spending on farming by the EU will free up resources to spend in other important areas, such as the development of ‘green technologies.’”*
- As in the example above, refer to the extent to which resources have been allocated efficiently (after all, economics is all about the allocation of resources!
- Consider the advantages and disadvantages of an economic ‘event’ or policy and come to a judgment about the relative merits or problems. For example, *“The decision to raise the indirect tax on petrol has presented households and firms with a number of different advantages, as outlined in the article. In the end, it can be concluded that the decision was a positive one because ...”*
- Look at the (implicit) assumptions behind the theories that you are using. These assumptions may not be valid in the context of your article. Remember that the conclusions drawn from applying economic theory often rely on the *ceteris paribus* assumption. In reality, this assumption cannot be made, since we cannot keep everything else the same in the real world. For example, you might look at an article about a bumper crop leading to a massive increase in the supply of cotton. Economic theory suggests that this will lead to a fall in the price of cotton, *ceteris paribus*. However, if at the same time there has been a significant fall in demand due to the world recession, then the impact of the increased supply might be very small, if there is any effect at all.

- Another assumption that is good to question is the assumption that the main goal of firms is to maximise profits. This may not be the case in your article, and so while you can present the theory and explain the outcomes suggested by the theory, this may not actually be the case in your article.
- Consider any elasticity values that might be implicit in the article. For example *"The price of corn tortillas has risen in Mexico, and the article refers to the enormous problems that this is creating for Mexicans. While all Mexicans will feel the effect of the price rise to some extent, the impact will be much greater on low income people, whose staple food is the corn tortilla. This makes their demand for tortillas very inelastic. Even though the price has increased, their demand falls by a proportionately smaller amount, and so their total expenditure on corn tortillas increases, leaving them with less income for other goods and services."*
- Consider why the theories that you have applied do not provide a full explanation of the situation described in the article. For example, *"Economic theory suggests that an increase in indirect taxes is regressive, putting greater financial pressure on lower income families. It is therefore unclear why the government is choosing to increase indirect taxes at a time when income inequality is already rising."*
- Consider the validity of the theory in the context of the article that you are analysing to come to the conclusion that what economic theory predicts may not be what happens in reality. *"Given the disadvantages associated with the anti-competitive behaviour displayed by the firms in this case, it is very positive that there is a competition commission to regulate the behaviour. However, it is possible that in reality, the commission has little power to prevent the price-fixing since it is so difficult to prove."*
- Identify any ideological underpinnings of arguments made in the text (the most obvious of these is related to the debate about whether resources are best allocated through the market mechanism or whether intervention is desirable). For example, an article about the role of fiscal policy in stimulating an economy is likely to imply some debate between Keynesian (interventionist) thinking and neo-classical (free market) thinking.

Possible phrases and sentences to use when evaluating:

1. This theory does not account for the . . .
2. This theory does not provide a full answer to the situation described in the article
3. On the other hand...
4. The extent to which this is likely to happen depends on . . .
5. Apart from economic theory, other factors also have an impact...
6. In the short term . . . However, in the long term . . .
7. The most important cost is..., because
8. Factor X is somewhat less significant than factor Y because . . .
9. Other stakeholders such as...
10. In reality the theory may not hold true, because...
11. This idea is often criticised because...

Do's and Don'ts

Do . . .

- Make a good effort! The portfolio is worth 20% of your final mark. A good portfolio can improve your overall grade.
- Use the IB Diploma Programme economics internal assessment criteria to guide your work.
- Find a suitable current article. Short articles, concerned with real economic matters, are recommended.
- Read the article carefully and highlight or underline relevant parts.
- Define relevant terms but note that there is no need to repeat terms you have already defined in earlier commentaries.
- Make sure you fully label all diagrams from the text. (If you are drawing a supply and demand diagram for the oil market, do not simply put Price [or even P] on the y axis - give the full information - price of oil/\$ per barrel). If there are figures in the extract, include them in the commentary.
- Provide quotations from the article, as well as any relevant numerical data.
- Apply relevant theory - link the theory to your particular extract.
- Highlight any fallacies in arguments and try to reach a balanced conclusion.
- Try to use a common style of presentation for each of your commentaries - a common font, size of print, style of heading. Although it is not a requirement, you are strongly recommended to type your work.
- Make sure that across your complete portfolio you refer to at least three sections of the syllabus
- Keep an electronic copy of all of your work – this includes the article, commentary and cover page. Do not simply save the link for the article as you may not be able to access it at a later date, and you may be required to do so. It should be copied and pasted into a word document (with all the appropriate bibliographic information – name of newspaper and url adress) and stored.

Don't . . .

- **Simply paraphrase or summarize the article (this is a common fault).**
- Leave it to the last minute to find an article
- Download the economics diagrams from an internet source
- Forget to include quotations from the article
- Forget to include an **accurate** word count
- Write more than 750 words.

Part 3

Writing the commentary

In this section I will present a selection of articles with guidance on how to write a commentary, together with actual commentaries that I consider to be appropriate to the selected articles.

Some of the articles are from actual printed sources but I have also made up some articles of my own that resemble the type of typical article found in English language newspapers.

To begin writing the commentary it is advisable to have read through the article carefully and to have identified concepts that can be defined and analysed together with appropriate diagrams that can be usefully applied to enhance your analysis.

Your first sentence should be a summary of what the article is about. Do not write irrelevant details that can be found elsewhere such as on the cover sheet. E.g. you should not begin by saying: "This article was written on 21st June by Joe Smith with the title...." All of this information is available on the cover sheet and represents unnecessary duplication of information. Having read through the article try to think of one sentence that answers the question: 'what is the article about?'

After the general introduction you should quickly get on to the specific points that you will define and analyse. These points need to be fully explained and if diagrams are used to support the analysis these must be neatly and clearly drawn and they must be fully labeled and fully explained. While using economic analysis and applying theory you should also be aware of the potential for some evaluation. This could take the form of identifying a difference between a short run and a long run effect. Alternatively, you might identify how different groups might be affected or the relative importance of the point that you are discussing. A final overall evaluation at the end is useful as a means of emphasising the main judgments that you have made in the course of writing the commentary.

Commentary 1

Article1

Source: *Traffic*, Thursday January 12th 2012

Rhino poaching deaths continue to increase in South Africa

Thursday, January 12, 2012 at 14:24

TRAFFIC in Enforcement, Mammals - rhinos, Smuggling in Africa, Smuggling to Asia

Despite increased law enforcement efforts, rhino poaching accelerated in South Africa last year. The country lost 448 rhinos to poaching in 2011, official government statistics reveal. The total includes 19 critically endangered Black Rhinos, of which fewer than 5,000 remain in the wild.

In 2010, 333 South African rhinos were killed by poachers, nearly three times the number killed in 2009.

"The rate of poaching increase may appear to be faltering, but the bottom line is more rhinos than ever were poached in 2011," said Dr Colman O Criodain, WWF's wildlife trade policy analyst. "If left unchecked, poaching gangs could put the survival of these iconic species in jeopardy."

More than half of South Africa's rhino deaths occurred in world-famous Kruger National Park. The popular safari destination lost 252 rhinos in 2011, and witnessed the poaching of an additional eight rhinos in the first weeks of the New Year, according to authorities from South Africa National Parks.

South African law enforcement officials made 232 poaching-related arrests in 2011, compared to 165 the previous year. Sentences imposed for rhino crimes have also increased in recent years, with poachers and horn smugglers receiving as long as 16 years in prison.

"Rhino poaching is being conducted by sophisticated international criminal syndicates that smuggle horns to Asia," said Dr Morné du Plessis, CEO of WWF-South Africa. "It's not enough to bust the little guy; investigators need to shut down the kingpins organizing these criminal operations. Governments in Africa and Asia must work together across borders to stop the illegal trade."

The recent upsurge in rhino poaching has been tied to increased demand for rhino horn in Asia, particularly Vietnam, where it carries prestige as a luxury item, as a post-partying cleanser, and also as a purported cancer cure.

"Rhino horn has gained popularity among wealthy Vietnamese elites and business people to give as a gift, when currying political favour, or taking as an antidote to overindulgence," said Tom Milliken, TRAFFIC's rhino trade expert. "But killing endangered rhinos to mitigate a hangover is a criminal way to see in the New Year." According to Traditional Chinese Medicine experts, rhino horn has no proven cancer treating properties. Contrary to popular myth, it has never been used in traditional medicine as an aphrodisiac.

The Convention on International Trade in Endangered Species of Wild Fauna and Flora (CITES) has found that consumer demand in Vietnam is driving much of the rhino poaching. CITES has also ruled that Vietnam needs to show progress in curtailing illegal trade in rhino parts and derivatives.

Some general points

I have selected this particular article because it is not typical of the type that the average IB economics student would select for their first commentary on microeconomics. It is not an obviously

economic article since it deals with the rhinoceros as an endangered species rather than the price of some commodity.

It does, however, provide adequate scope for writing a good economics based commentary which identifies and analyses economic concepts relevant to section 1 of the syllabus.

The following is a list of relevant concepts that can be identified and applied:

- Income elasticity of demand
- Price elasticity of demand
- Veblen goods (though no longer in the syllabus)
- Costs of production
- Complementary goods
- Market failure
- Negative externalities
- Sustainable development
- Government failure
- Illegal/parallel markets
- The assumption of rational consumer behaviour
- Price signals and the function of the price mechanism

I am sure that a more perceptive person would be able to find a few more economic concepts hidden in this article, but there is clearly enough here to provide the basis of a sound economic commentary. From the above potential list it is also possible to identify the following relevant diagrams that could be usefully applied:

1. Increased demand causing price of Rhino horn to rise.
2. Shift in supply to the left in the long run as Rhino's approach extinction.
3. The same diagram can be used to show increase in costs of production for Kruger national park as a result of increased security to limit poaching. (HL students could use a *theory of the firm* diagram to show effect on profits)
4. Negative consumption externality since consumption in Vietnam has negative spillover effects for conservationists and safari tour operators.
5. Inward shift of PPC for South Africa as non-renewable resource is depleted (unsustainable development)

Again this is by no means an exhaustive list of potential diagrams and I do not propose to use all of the above.

For evaluation I will rely on:

1. The identification of different groups of stake holders who are affected by the trade in horns.
2. The long term allocation function of the price mechanism
3. The costs and benefits of unregulated markets.

The following represents what I believe to be a sound commentary based on the above article that would objectively score highly in each criterion category.

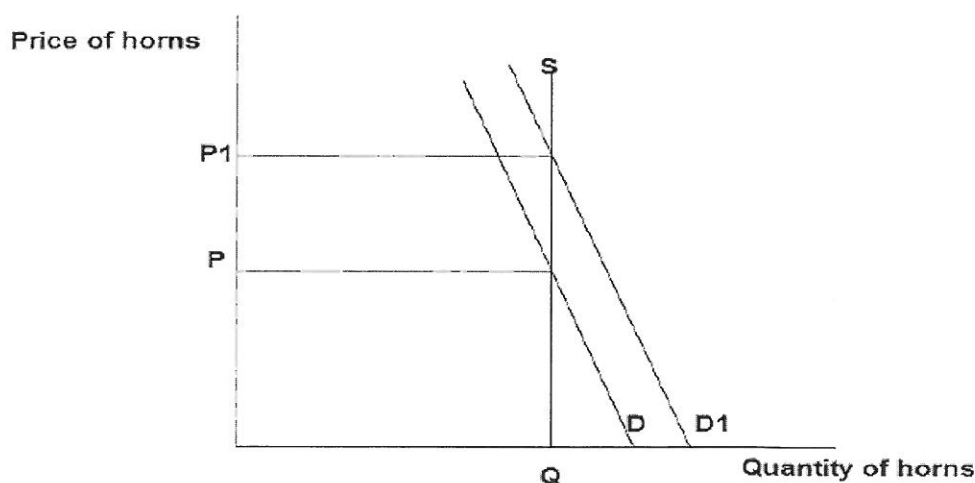
Commentary

This article provides an interesting insight into the danger of extinction of the rhinoceros as a result of increased illegal poaching in South African national parks. The animal is killed for its horns which are mistakenly believed to have medical powers as cures for a variety of things. I would take out the word mistakenly. Rich Vietnamese defy rational consumer behaviour by fuelling the demand and this has made the poaching of the horns extremely profitable. This sentence is a bit too polemic.

The increase in demand is related to economic growth in Asia and it is clear that rhinohorns have a high positive income elasticity of demand. This means that as incomes rise by say 10% the demand for horns increases by 20%. Given that the horns are bought as luxury items, we can expect that the demand will be price inelastic so that a 10% increase in price will lead to a fall in demand of less than 10%.

The following diagram shows the effect of rising demand on the price of rhino horns

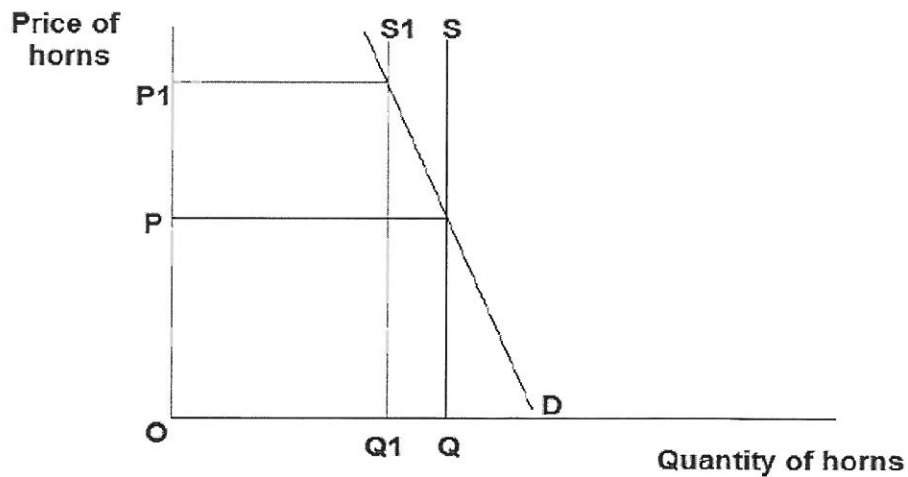
Diagram 1



As demand from Vietnam increases from D to $D1$ the price rises to $P1$ and this provides an incentive for poachers to face the risks of imprisonment and to increase the supply of horn. This increased supply can only occur in the short run however, because killing rhinos is unsustainable and as a result

the long run supply will decrease as shown in diagram 2. Supply is represented as a vertical line because there is a fixed number of Rhino horns in existence at any point in time and therefore the supply is perfectly inelastic.

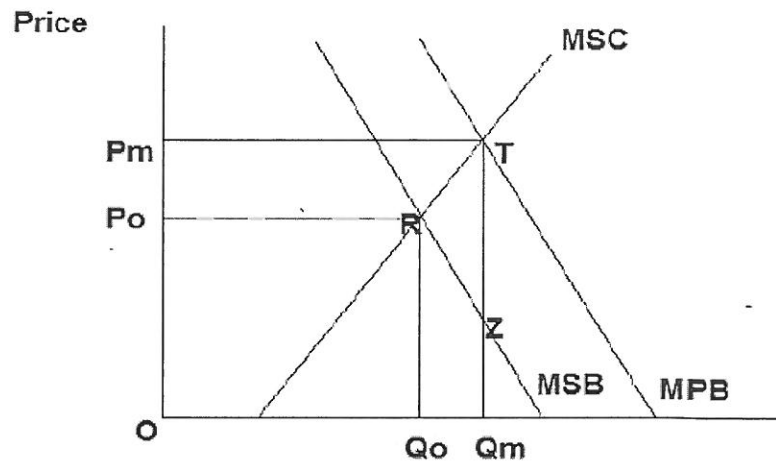
Diagram 2



As supply decreases to S_1 price rises significantly to P_1 and this should reduce demand to a more sustainable level. Unfortunately, market forces do not operate to achieve this because the demand is very inelastic and in the long run will continue shifting to the right as incomes in Asia continue to rise.

The private benefit gained by the consumers in Asia and the poachers in Africa is relatively small compared to the economic and social costs imposed on the sustainability of Africa's wildlife tourist industry and the sensibilities of the average western wild life enthusiast. This presents a classic case of market failure whereby the consumption of a good generates a larger marginal private benefit to consumers than the marginal social benefit, or in this case cost, to the rest of society. From a world point of view the rhino is being over consumed to the extent that its very existence is being threatened. This market failure and the resulting welfare loss are illustrated in diagram 3.

Diagram 3



In diagram 3 the private benefit from consumption is greater than the social benefit thus creating a market failure of overconsumption $Q_m - Q_o$ and a welfare loss represented by the triangle RTZ .

The use of rhino horns for medicinal purposes is highly unjustifiable and causes much higher costs than any benefits. A cost benefit analysis that compared the economic and social costs and benefits would certainly lead to the conclusion that more stakeholders lose more than the stakeholders that gain. The gainers are the poachers, who are probably poor Africans with little alternative sources of income, the Asian consumers and the criminal gangs who manage the illegal trade. In contrast the stakeholders that lose are the owners of the national parks, the tour operators who will face ever decreasing demand for Safaris in the long run as the wildlife is endangered, the average western citizen who values biodiversity and ultimately the average South African citizen who will suffer reduced growth and development in the future as a natural resource becomes used up.

It is, however, possible that the price mechanism will come to the rescue of the rhino. If the current trend continues the price of rhino horns will rise significantly and it might become easier and more profitable to raise rhino's on farms than to kill the existing ones. Zoos are likely to place greater value on raising rhino's in captivity and Park keepers will become more vigilant to prevent poaching. In addition, western 'save the rhino' pressure groups will campaign against the use of horns in Asia and it might become less fashionable to use horn medicine among the new generation of wealthy Vietnamese.

As a resource becomes scarcer, the price mechanism will operate to reduce its consumption, increase its supply and generate a demand for substitutes to be developed. It might be possible to manufacture fake horns that are indistinguishable from the real thing in the long run.

Commentary 2

Article 2

Source: GRG Imaginary News

Oil prices edge higher as Iran trade embargo begins to bite.

Oil prices edged above \$100 a barrel yesterday as speculators feared that the trade restrictions imposed on Iran would begin to squeeze oil supplies. Some analysts were confident that any supply shortages would be remedied by increased production from Saudi Arabia as well as from non OPEC producers such as Norway and Russia. A spokesman for Oil International however, pointed out that although long term oil supplies were quite buoyant, it would take at least a few months for current supply to be increased.

The manager of the US oil reserve tried to play down the recent price rise claiming that the weakness in the Global economy is still depressing oil demand so that prices will soon fall back to below \$100 a barrel. He said that US oil reserves were at a healthy level and that there were no fears of supply shortages even if the winter turned out to be colder than usual.

A professor of mineralogy at Conduit University commented that the fears of oil

reserves becoming rapidly depleted in the near future were vastly exaggerated. New discoveries combined with new techniques of extraction from shale would increase world supply significantly over the next 20 years. This combined with the development of alternative energy sources would contribute to reasonably low prices in the coming years rather than the nightmare scenarios that some analysts had predicted of prices rising above \$200 a barrel.

Despite these optimistic views, the UK government has postponed a planned increase in the tax on petrol that would have brought a much needed increase in revenues, for fear of stalling the already feeble recovery.

Some general points

This is a much more straight forward article and presents a familiar situation with oil prices rising. Specific reasons are mentioned and it is relatively easy to identify the appropriate diagrams that can be used to analyse the situation.

The price rise is blamed on speculators which mean speculative buying of oil in anticipation of future supply restrictions. This can be illustrated with a shift in demand to the right that causes the current price to rise. The future oil supply restriction can also be illustrated with a shift in supply to the left which will also cause price to rise in the future.

Alternatively, the expected increase in oil supply can be illustrated as a shift in supply to the right that will cause future prices to fall. The fact that this is likely to take a few months can be used as evidence that the supply of oil is very inelastic and provides an opportunity to introduce the concept of supply elasticity with an appropriate definition.

Price elasticity of demand can also be inferred from the last paragraph which refers to the expected increase in revenue if petrol tax was raised. A diagram showing the effect of a tax could also be used here.

Clearly, there is scope for a few similar supply and demand diagrams to illustrate the current and future oil market. In addition, some useful references to elasticity can be made. At a push, it might be possible to introduce some higher level analysis through the reference to OPEC which is a cartel. Some discussion of how cartels operate, with an appropriate monopoly diagram, could be applied although the relevance is a bit marginal.

A better alternative would be to show the effect on a firm's profitability of the increase in costs resulting from the increase in oil prices.

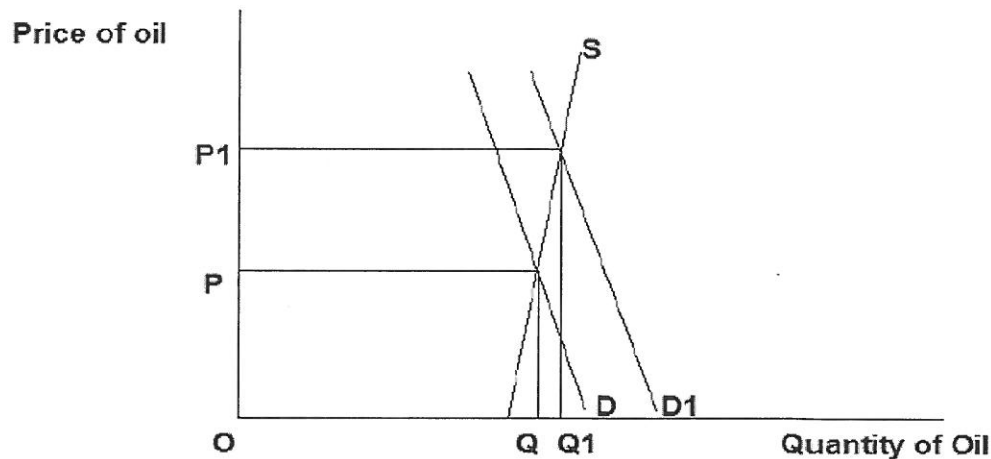
With respect to evaluation, there is the short run versus long run comparison which is referred to in the article but this is not sufficient on its own. What would be advisable is to consider the long term role of the price mechanism in influencing the allocation of resources. The third paragraph of the article provides clues for this. It refers to the new discoveries and developments which can be assumed to be inspired by high oil prices that provide a signal that oil extraction is profitable. Similarly, there is the reference to the development of alternative energy sources which again is related to price signals. In this context, it would also be possible to introduce the concept of cross elasticity of demand with an appropriate diagram.

Although not quite as interesting and challenging as the first article, it is nevertheless possible to write a perfectly acceptable commentary using this type of article.

Commentary

This article examines the impact of rising oil prices on current and future economic development. The apparent cause of the recent increase in price is speculative buying of oil in anticipation of supply restrictions in the near future. This is shown in diagram 1.

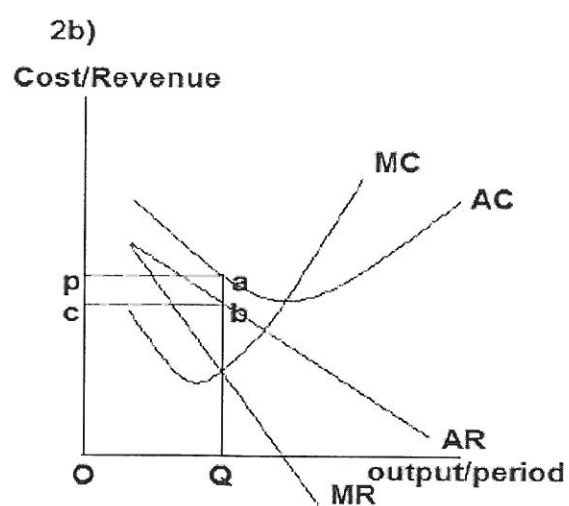
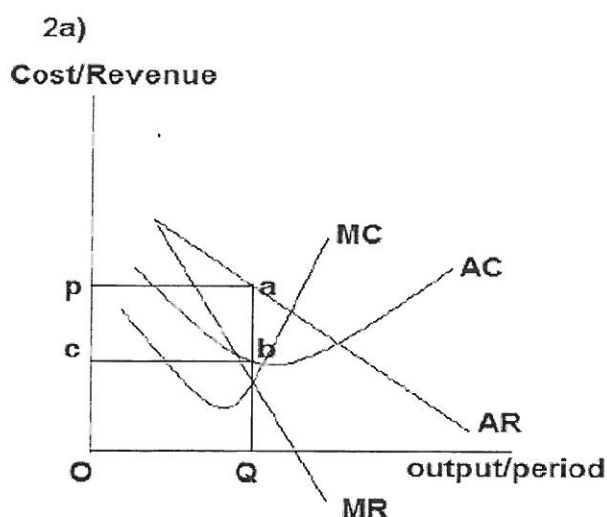
Diagram 1



Speculative buying is represented by the shift in demand to D_1 , causing price to increase to P_1 . Speculators fear the possibility of an embargo on Iran which will reduce future oil supplies and although the shortage could be filled by other producers, it will take some time for this to happen. This suggests that the supply of oil is very inelastic, in the short run, because supply does not respond quickly to price changes. Consequently, a relatively small increase in demand, as shown in diagram 1, can have a relatively large impact on price.

Oil is a non-renewable resource and there are growing fears that it will run out in the near future and as it becomes scarcer, prices will rise dramatically. If this is the case, then any growth resulting from using oil is unsustainable since it will be at the expense of future generations. Furthermore, if prices continue to rise, it would have a very negative effect on the world economy with costs of production rising for many firms. With an oil price of \$200 a barrel, many firms would be forced out of business as costs would rise above revenue. Such a situation is shown in diagram 2.

Diagram 2



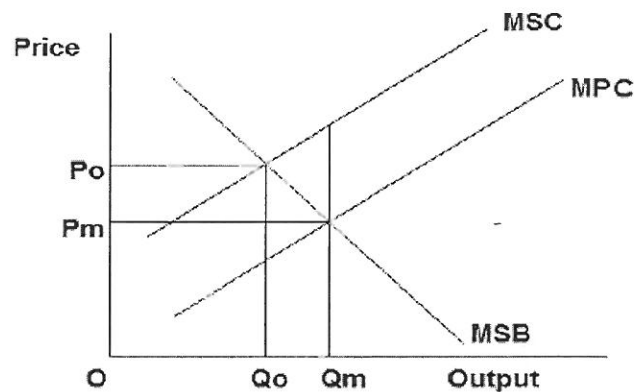
In diagram 2a) the firm is making economic profit represented by the area PABC since $AR > AC$. In 2b) however, costs have risen above revenue, so the firm is now making a loss equal to the area PABC. In the long run, such loss making firms will be forced to close down, while at the same time consumers will be faced with high prices for goods.

These fears are considered to be exaggerated by some economists and experts and there are even expectations that new discoveries will be made. This optimistic view is based on the belief that the price mechanism will provide the necessary signals to solve the problem of scarcity.

High oil prices might have bad consequences in the short run but, in the long run, they will act positively to reallocate resources more efficiently. High prices will provide a signal to producers who will find new reserves to develop and new techniques to extract oil from high cost sources such as shale. In addition, entrepreneurs will see that there are profits to be made in developing substitutes for oil, such as the various sources of renewable energy. This will not only solve the energy problem in the long run but will also promote growth and sustainable development as well as reducing the negative externalities of burning oil to provide energy.

If an oil fired electricity generator is replaced by a wind turbine, there will be a marked reduction in the negative externality of pollution and the market failure that it causes. This is shown in diagram 3.

Diagram 3



Using oil to generate electricity, imposes a cost on society in addition to the private cost of supplying the electricity. This cost is shown as the negative externality and means that the total cost to society, represented by MSC is greater than the economic cost of production represented by MPC. Using wind power will remove this external cost completely and cure the market failure by equating MSB and MSC at P_0 and Q_0 .

If high oil prices do stimulate the use of renewable clean energy, then there will be definite long run benefits. In addition, the price signals will give incentives for engineers to devise engines that use much less fuel and/or adapt them to use renewable energy. Furthermore, consumers will increasingly switch to lower cost substitutes such as public transport rather than using their cars.

All of these effects will depend on the relative cross elasticity of demand between, on the one hand, oil and its derivatives and their substitutes (wind, solar, hydro etc.) and, on the other hand, oil and its derivatives and their complements (cars, ships, planes etc.). As oil prices rise, the demand for substitutes and complements will become increasingly responsive. E.g. if the price of petrol rises by 10% and the cross elasticity of demand for biofuel is +2 and for cars is -1.5 , there will be a 20% increase in the demand for biofuel and a 15% decrease in the demand for cars.

Commentary 3

Article 3

Source: Athens News June 5th 2012

India preparing for euro zone meltdown

5th June 2012

India has prepared a contingency plan for Greece exiting the euro zone and even a collapse of the monetary union, Indian officials said on Tuesday.

The euro zone debt crisis has already put a damper on India's exports to Europe, the biggest destination for Indian goods, as well as capital inflows into equity and debt markets. Prime Minister Manmohan Singh's government blames Europe's woes for the slowdown in Asia's third-biggest economy, although economists say Indian policy inertia is also to blame. Finance chiefs of the Group of Seven leading industrialised powers will hold emergency talks on the euro zone crisis on Tuesday in what was seen as a sign of growing global alarm over the threat posed by the strains within the 17-nation union.

"Yes, India does have a contingency plan. There are different crisis management groups within the government to deal with such a possible scenario," Kaushik Basu, the chief economic adviser to Finance Minister Pranab Mukherjee, told Reuters. He declined to give details of the plan, but another senior official familiar with the planning said the Finance Ministry and central bank were prepared to take monetary and fiscal measures if necessary to try to insulate India from the shockwaves of a euro zone collapse.

He did not spell out the measures, but they could include lowering interest rates, which are among the highest in the world, and lowering the amount of money that banks have to keep on deposit in the central bank.

The latter step would allow banks to lend more money to firms to keep hiring and expanding. At the moment the banks are required to keep 4.75 percent of their deposits with the Reserve Bank of India.

Banking on falling oil prices

The Indian government is also banking on lower international oil prices, to help blunt the impact of any European crisis. India imports nearly 80 percent of its oil requirements and heavily subsidizes diesel and kerosene that is used mainly by the country's poor and public transport.

During the 2008 financial crisis, the Indian government spent its way out of trouble by increasing spending on job-creating infrastructure projects and tax cuts that boosted consumer spending, a major driver of the economy.

This time around, with the budget deficit at nearly 6 percent of GDP, thanks in no small part to that stimulus spending, it does not have the same room to manoeuvre.

Some general points

This is a fairly straightforward article that deals with the relationships between countries in the world economy and the effects that these may have on domestic economies. The syllabus content is clearly Macroeconomics but with some inevitable references to International Trade in so far as they affect AD and AS.

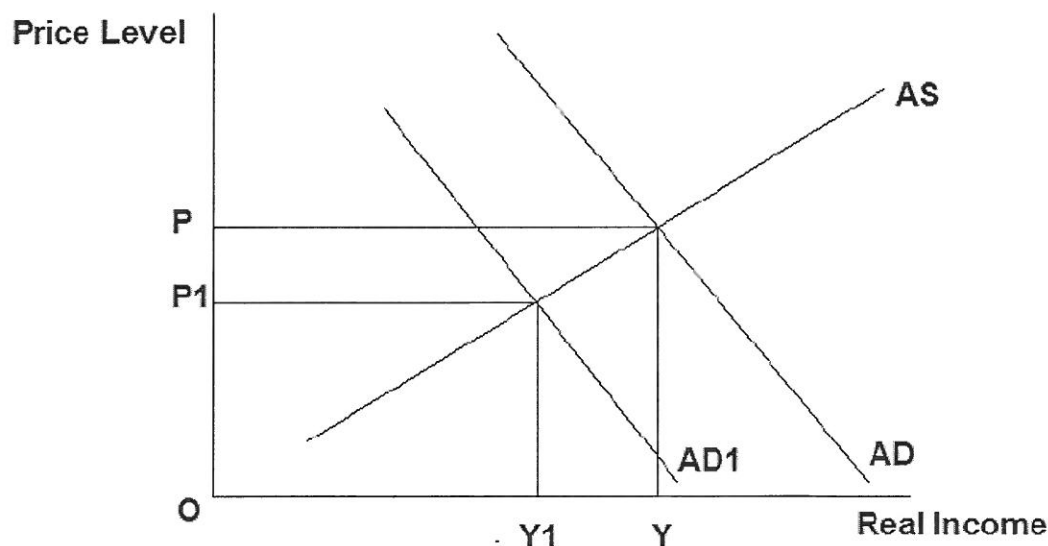
The analysis will typically involve applications of the AD/AS model to show sources of problems and potential solutions.

Commentary

This article looks at the fate of the Indian economy in the light of the current crisis in the Eurozone. India is facing a significant fall in its exports to Europe and this will have a severe effect on domestic output and income. Europe is the main destination for Indian exports and if the Euro crisis worsens with a possible Greek exit, then India will have to be prepared with a contingency plan.

For a country like India, exports are a significant component of AD and if Europe is importing less then India will export less and AD will fall with the consequences shown in diagram 1.

Diagram 1

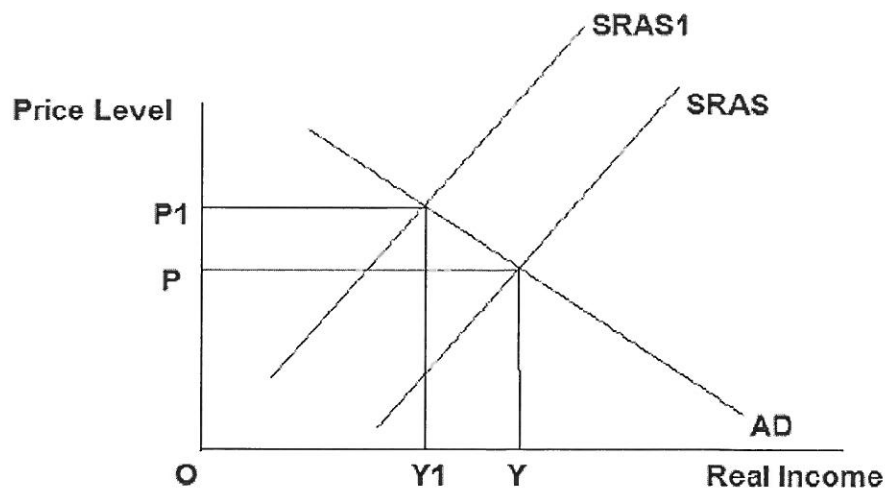


The decrease in exports will shift AD to the left to AD1 and as a result there will be a decrease in real income and output to Y1 which means that unemployment will increase as well. The only positive effect is the fall in the price level from P to P1 which will reduce inflationary pressure.

It is possible to deduce that India has a potential problem with inflation because one of the suggested policies is "lowering interest rates, which are among the highest in the world". In addition, the government is hoping that oil prices will fall because it imports 80% of its oil requirements. High

interest rates are a typical contractionary monetary policy which aims to reduce credit financed consumption and has the same effect as shown in diagram 1. High oil prices will cause domestic costs of production to rise and this will stimulate cost-push inflation as shown in diagram 2.

Diagram 2



Increased production costs cause the short run AS to shift to the left and as a result the price level rises to P_1 thus stimulating further inflationary pressure. In addition to this effect, there is also a negative effect on real income which falls to Y_1 and contributes to a further weakening of domestic production. This is why it is so important for oil prices to fall.

These effects clearly show the problems that are faced when using demand side policies to achieve economic objectives. The current concern of the Indian government is to boost domestic production and prevent unemployment from increasing. It could potentially use an expansionary fiscal policy to achieve this, but having used such policies in the past the budget deficit is now too large for any further significant increases in Government spending or decreases in taxation to be implemented. This means that the demand side expansion has to be exclusively through the use of monetary policy and specifically by cutting interest rates.

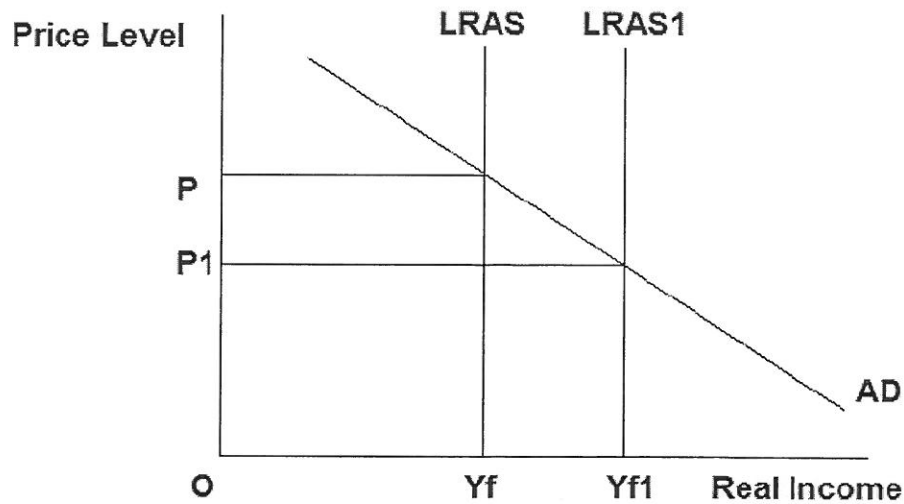
There are two problems associated with this. The first is the conflict with the objective of controlling inflation. As is evident from diagram 1, it is not possible to stimulate output, income and employment without at the same time causing inflationary pressure. Any increase in inflation will make it even more difficult for Indian exporters to sell their products to hard pressed European consumers.

The second problem is the possible effect that changes in interest rates have on the exchange rate of the country's currency. Decreasing interest rates will cause the exchange rate to weaken and although this will initially boost exports through lower export prices it will feed through to higher inflation as import prices rise. This is particularly significant for India with its high oil imports and reliance on imported raw materials.

There is, however, an alternative to these policy conflicts, which is the use of supply side policies. A

successful supply side policy would have the effect shown in diagram 3.

Diagram 3



By shifting the long run AS to LRAS1 it is possible to achieve an increase in output, income and employment while at the same time reducing the price level and therefore inflation. Such policies could include deregulation and privatisation together with measures to make the labour market more flexible. In the long run, the boost to the supply side would improve the performance of the Indian economy while avoiding the short run conflict of objectives associated with demand side policies.

Commentary 4

Article 4

Source: GRG imaginary news

ECB urged to take a more positive stance to reverse the trend in rising unemployment

With no solution in sight to the ongoing Eurozone crisis and unemployment creeping up in many countries, representatives of the US Federal Reserve are urging the ECB to take firmer action in the hope of moving the EU out of recession.

Apart from a recent 25 point decrease in interest rates, the ECB has been conspicuously reluctant to intervene in the money market in order to increase liquidity. Unlike the Fed which has engaged in two rounds of quantitative easing, the ECB is stubbornly avoiding any intervention in the bond market.

Even the normally cautious Bank of England has experimented with quantitative easing despite concerns regarding inflation.

With unemployment in both Greece and Spain above 23% and rising and concerns that unemployment is creeping up throughout the EU, some bold action is needed by the Central Bank since expansionary fiscal policy is not a practical option for some highly indebted countries.

Many economists are challenging the traditional view that inflation must be kept below 2% and are urging governments to

sacrifice inflation targets in order to contain rising unemployment. During the 1980's rapid growth was achieved in the USA with inflation rates above 4% with no apparent detrimental long run effects.

The costs of moderate inflation are greatly exaggerated and are a small price to pay in order to get the EU economies back on track. Those countries that can should follow the US example of more public spending on infrastructure projects combined with extensive bond buying by the ECB to facilitate this.

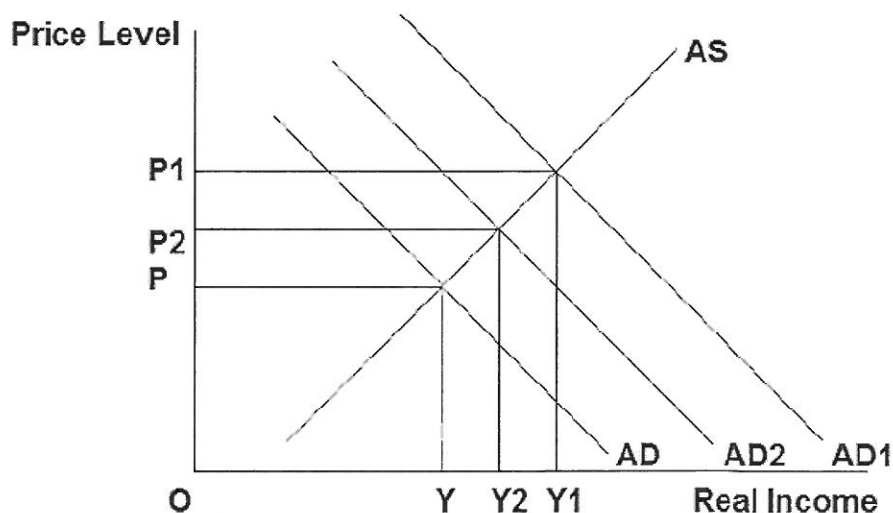
Commentary

This article reflects the differences of opinion between the Federal Reserve and the ECB, which underlie their views on inflation and unemployment. To some extent, the Fed seems to support a Keynesian viewpoint while the ECB is more neoclassical in its approach.

The key difference is the use of quantitative easing which is the process by which the Central Bank buys back government bonds. This has the effect of keeping interest rates low, as well as injecting extra liquidity into the financial system. The hope is that the banking system will be more able and willing to provide investment loans to firms which will stimulate recovery from the current recession. Many EU countries have experienced more than the two consecutive quarters of negative growth associated with recession and the US is concerned for the EU to begin a sustained recovery which will also consolidate the US recovery.

Quantitative easing (or simply increasing the money supply) is what Keynes had recommended as the necessary monetary policy to supplement expansionary fiscal policy and thus preclude the possibility of crowding out. This is illustrated in diagram 1.

Diagram 1

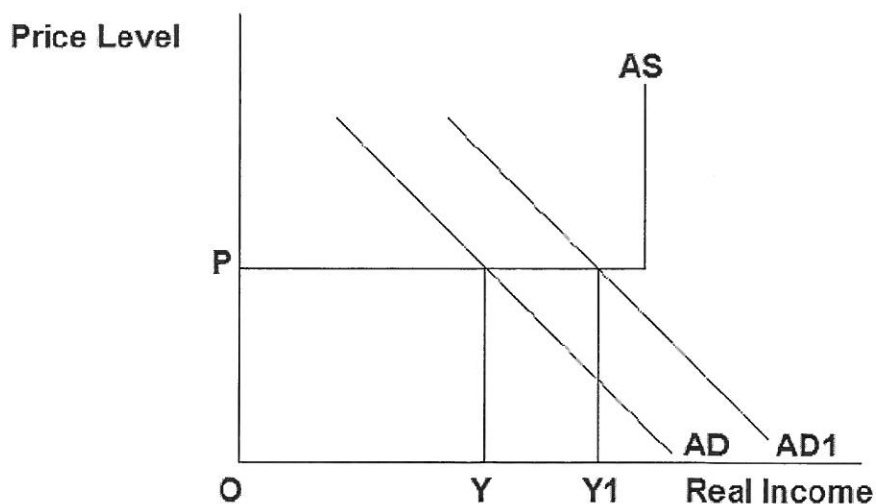


If the government tries to remove a deflationary gap with an expansionary fiscal policy, the necessary borrowing will cause interest rates to rise which will reduce the expansionary effect of the increased Government spending. In diagram 1, the fiscal expansion shifts AD to AD1 and leads to an increase in income and output to Y1. The increased borrowing requirement, however, will raise the rate of interest and this will curtail consumer spending so that AD shifts back to AD2. Income and output fall back to Y2 and are said to be crowded out.

This effect can be avoided by quantitative easing which will maintain interest rates at a low level and it gives the government the option of tackling the recession with a fiscal expansion, as the US government has done.

Whether fiscal expansions lead to higher inflation depends on the slope of the AS curve. The experience in the US and the UK suggests that AS is relatively flat so that the danger of inflation is small. This is shown in Diagram 2.

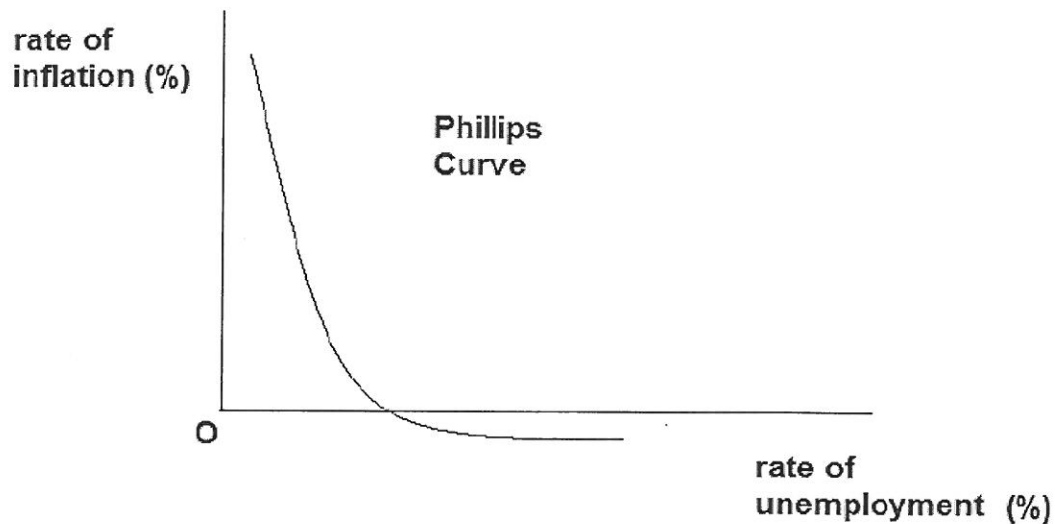
Diagram 2.



Any shift in AD along the horizontal section of AS will only have real effects in the economy and no price effects. By shifting AD to AD1, income and output increase to Y1 with no increase in prices and therefore inflation. In such circumstances there does not appear to be any danger from increasing AD with fiscal or monetary (quantitative easing) policies. The ECB is, presumably, of the opinion that the AS is steeper or even vertical so that any demand side expansion will raise prices.

This can be shown with the Phillips Curve diagram below.

Diagram 3. The Phillips Curve.



From the Phillips curve diagram it is clear that any decrease in unemployment will simply lead to an increase in inflation as the two are inversely related.

Whether this is a satisfactory price to pay is a matter of opinion. As the article states, traditional views like those of the ECB consider the opportunity cost to be too high, while modern interventionist economists would consider it a small price to pay.

It is appropriate at this stage to distinguish between different types of unemployment. So far we have assumed that the unemployment is cyclical or demand deficient and will therefore be responsive to demand side policies. If, however, the unemployment is structural, being caused by loss of demand for a product because of cheap foreign competition, only supply side policies will be appropriate. It is likely that some of Europe's unemployment is structural and therefore will not be cured with increased AD. What Europe needs is a policy that increases the occupational and geographical mobility of labour and a general policy that improves labour productivity. For countries like Greece and Spain, supply side policies such as deregulation and privatisation are probably as important as demand side policies.

Commentary 5

Article5

Source: GRG Imaginary News

Euro crisis strengthens calls for UK exit from EU

The ongoing debt crisis in Europe has strengthened the Euro sceptic call for Britain to leave the EU. Recent figures show that the value of UK non EU exports has surpassed its EU exports and the trend is likely to continue given Europe's sluggish growth.

The anti Europe lobby is still gloating over the Euro's problems and uses the crisis as evidence to support Britain's decision not to join the common currency.

Despite the current EU's problems, the anti Europe lobby is naïve in its opinions and rather superficial in its analysis of events. The EU is the world's largest market and the benefits of membership are not confined to the free trade between members but include the influence that it has in the global economy.

Its size as a trading bloc gives it significant weight in trade negotiations and famously the EU was able to get the support of the WTO against the USA when it imposed tariffs on steel imports in 2003. By using the threat of retaliation with counter tariffs the USA was obliged to back down and removed the tariffs. In addition the EU is much better placed to engage in bilateral trading agreements and to negotiate deals with other trading blocs such as ASEAN and MERCUSOR.

These benefits would not be achieved by Britain operating in isolation and are only gained through membership of the EU. Given the complexities of trade negotiations in a recessionary global economy, it is much better to be a member of a large influential club than a loner.

Some economists would go further and claim that the Euro crisis shows that Britain's arguments in favour of keeping the pound sterling are actually flawed. Theoretically the advantage of being outside the Euro is that the UK can pursue an independent monetary and Exchange rate policy. In actual fact, rather than the pound depreciating against the Euro, the opposite has happened and this is a major reason for Britain's loss of exports to the EU.

Commentary

This article is interesting because it examines some of the less obvious benefits of belonging to a trading bloc, in addition to the traditional ones relating to trade creation and trade diversion. The anti-EU view is that Britain might gain from trade creation within the EU by having free trade with other members, but that it will increasingly lose out from trade diversion as a result of the common external tariff on non members. This is especially relevant now, given Britain's increasing exports to non EU countries.

As the article points out, however, this view is rather simplistic for a variety of reasons. Firstly, the EU is the world's largest market and has considerable negotiating power in world trade negotiations. It was able to enlist the support of the WTO when faced by steel tariffs imposed by the USA. The effects of tariffs are shown in diagram 1.

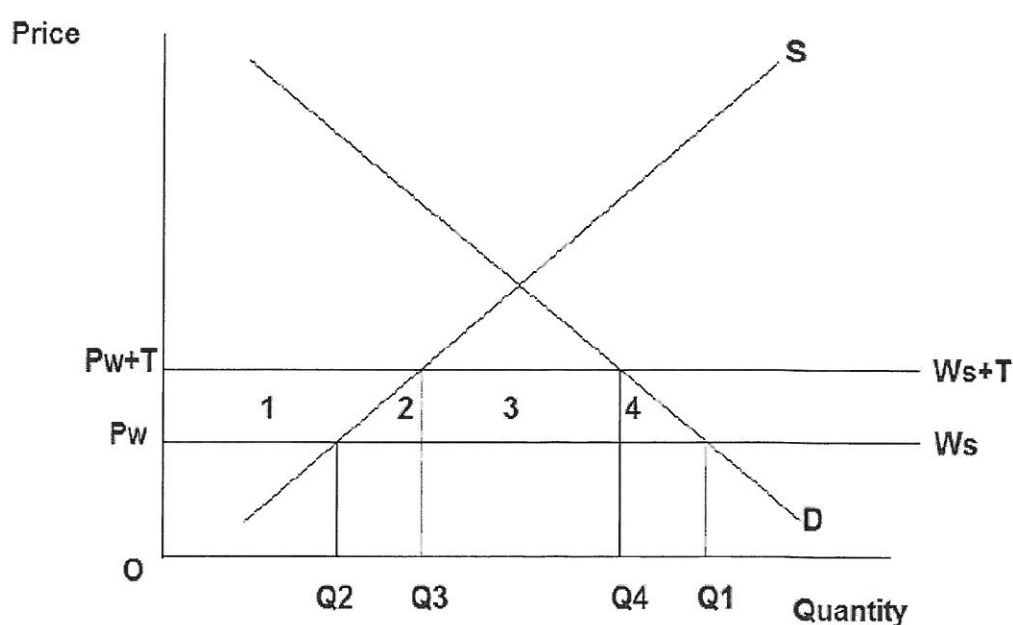


Diagram 1

The aim of the USA was to boost employment in the domestic steel industry by increasing domestic output from Q_2 to Q_3 . This was achieved by imposing the tariff that shifts the world price up to $P_w + T$ and as a result imports of steel were reduced from $Q_1 - Q_2$, to $Q_4 - Q_3$. US consumers suffered : loss of consumer surplus equal to area 1+2+3+4 while the government gained area 3 as revenue and steel producers gained area 1. This leaves a deadweight loss represented by areas 2 and 4.

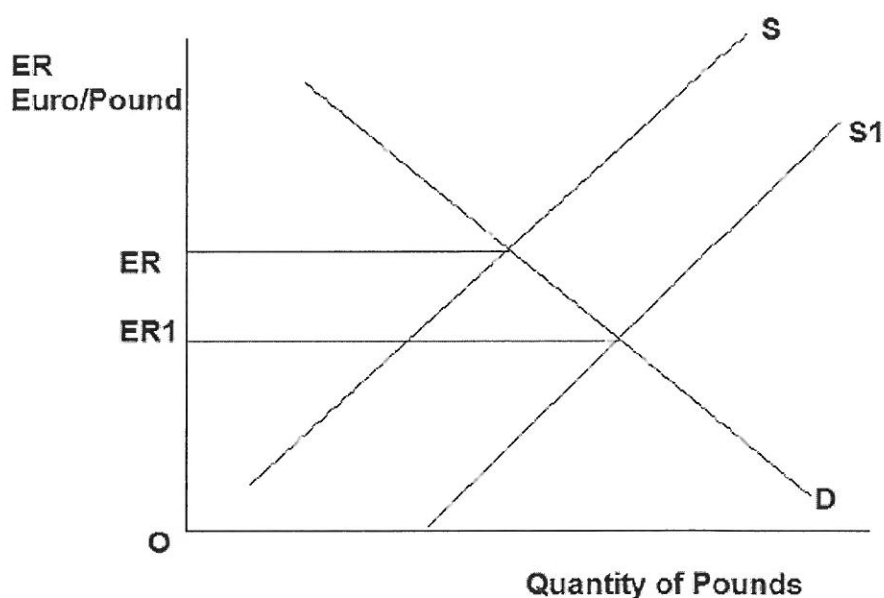
Overall, the tariff would appear to have more costs than benefits, especially if we recognise that higher steel prices will increase costs of production for US car manufacturers and other producers that use steel.

This experience with the EU supported by the WTO and the USA shows that the threat of tariffs is possibly more powerful than the actual tariff and it is only by being a member of a powerful bloc that the threat can be effectively used.

Another interesting point mentioned in the article is the ability of a country to depreciate its currency in order to reduce the effects of a recession. Theoretically, the UK can do this by being outside the Euro, but Euro zone countries do not have the option.

In order to depreciate a currency, the central Bank of the country needs to intervene in the foreign exchange market as shown in diagram 2.

Diagram 2.



In order to depreciate the pound against the Euro, the Bank of England will have to enter the foreign exchange market and sell pounds in exchange for foreign currencies. This is shown by the shift in the supply of pounds to S1 and as a result the exchange rate will depreciate to ER1. The lower exchange rate will make British exports more competitive relative to imports and this should lead to an increase in net exports which will boost Britain's AD and help stimulate recovery. In reality, however, this did not happen. What did occur was, in fact, the reverse. The Euro crisis led to a sharp depreciation of the Euro and the pound actually appreciated against the Euro. The effect of this was to reduce the competitiveness of UK exports which is the most likely reason for the relative fall in UK exports to Europe.

Alternatively, the Bank of England could try to depreciate the pound by lowering interest rates. This would reduce the returns on UK financial assets and would cause an outflow of short term capital thus putting pressure on the exchange rate to fall. With actual interest rates at a historic low of 0.5% however, this is not an option.

It would appear that the theoretical advantages of Britain maintaining its own independent currency are exaggerated. If the UK had adopted the Euro, it would have benefitted by the Euro's depreciation against the dollar and the Yen and its exports would be significantly higher than at present. As it is, the Euro crisis has simply led to a strong pound which, in turn, weakens the UK recovery.

Commentary 6

Article6

Source: GRG Imaginary News

Recession proves to be the best solution to the problem of trade deficits.

In the year before the financial crisis brought the boom to an end, many countries were facing a growing problem with their current account deficits. The USA had a deficit in excess of 6% of GDP and Greece held the record for OECD countries with a deficit of above 14% of GDP. Britain was another large deficit country and there were concerns that trade imbalances had grown too large.

The other side of the coin was the large surpluses of countries like China, Germany and the oil exporting Middle East. The USA/China deficit was to occupy trade relations between the two countries regularly with accusations of unfair practices from both sides. The USA claimed that China was subsidizing its exports by keeping its currency undervalued and threatened to impose restrictions on Chinese imports. China countered with claims that the Americans were mismanaging their budget deficit and blaming China for the consequences.

These trade disputes have gradually lessened, largely because of the significant reduction in the size of the imbalances. The US deficit has fallen to 3.2% of GDP, the Chinese surplus has fallen to 2.7% of GDP and even Greece

has reduced its deficit to 6.9% of GDP. What miraculous policy has solved the problem? The answer is none. It is the recession that has brought the imbalances to a more manageable level. By reducing incomes and consumer confidence, the recession has reduced the demand for imports and this has in turn reduced the current account deficits. Similarly this has had a corresponding effect on the surpluses which have also fallen.

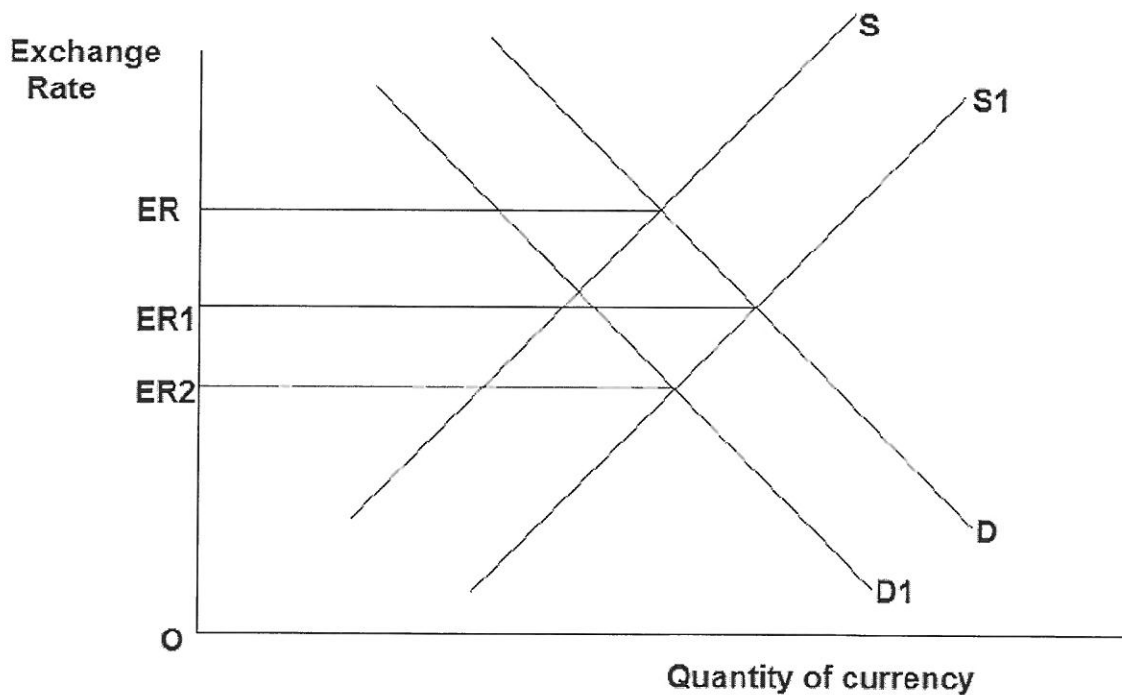
Theoretically, there is a self correcting mechanism under a system of floating exchange rates, whereby a deficit will lead to currency depreciation that ultimately corrects the deficit. In real life, however, it seems that this process either does not work or works too slowly to be effective. Recession is by far the best cure for large trade imbalances.

Commentary

This article examines the links between domestic incomes and trade balances. Specifically, it claims that the automatic exchange rate mechanisms do not work and that the only effective cure for a current account deficit is a recession. A current account deficit means that the value of a country's exports of goods and services is less than the value of its imports of goods and services. If the deficit is persistent and large ($>2\%$ of GDP), it is regarded to be a potential problem which requires correction.

Traditional economic theory offers two possible solutions to a deficit problem: expenditure switching and expenditure reducing. A popular 'switching' policy is to depreciate the currency and so switch demand to a country's exports, which are now cheaper, and away from imports, which are now more expensive. Under a system of floating exchange rates, a deficit should itself cause the exchange rate to depreciate as shown in diagram 1.

Diagram 1



A deficit means that imports are increasing relative to exports so this will cause the supply of the currency to increase from S to S1 and/or the demand for the currency to decrease from D to D1. Either will cause the exchange rate to depreciate to ER1 or ER2. By making exports more competitive and imports less competitive, this in turn should increase export revenues and decrease expenditure on imports so that the deficit will decrease. According to the article, this automatic process does not work, either at all or quickly enough.

One possible reason for this is that the Marshall-Lerner condition is not satisfied, in which case, the combined price elasticity of demand for exports and imports is less than 1. In such a case, a depreciation of the currency will lead to an increase in the deficit. e.g. if the demand for imports is inelastic, then an increase in their price will lead to a less than proportionate decrease in demand so the total spending on imports will rise. It is unlikely that the Marshall-Lerner condition would not be satisfied permanently in a developed economy, but it might not be satisfied in the short run. This situation is described as the j-curve effect and is shown in diagram 2.

Diagram 2

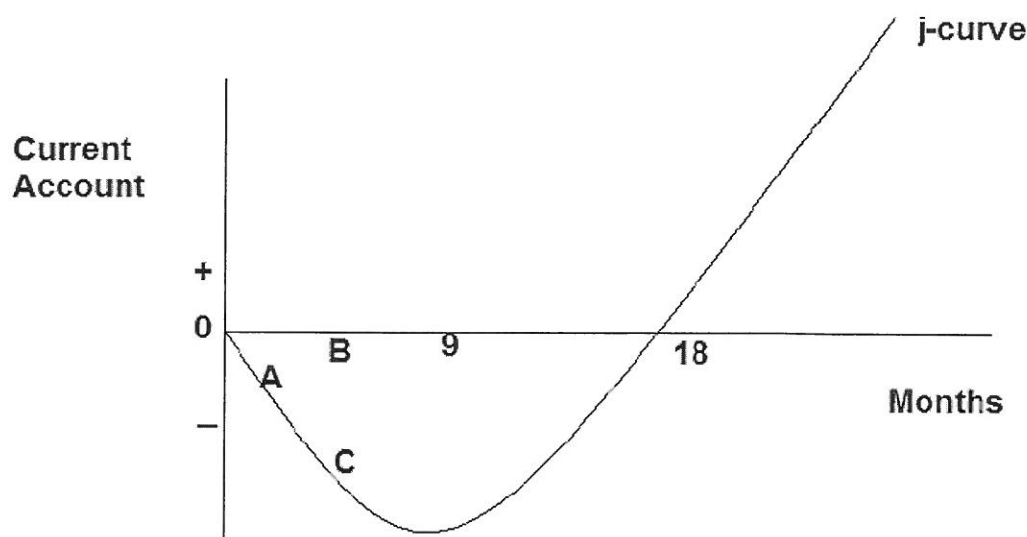
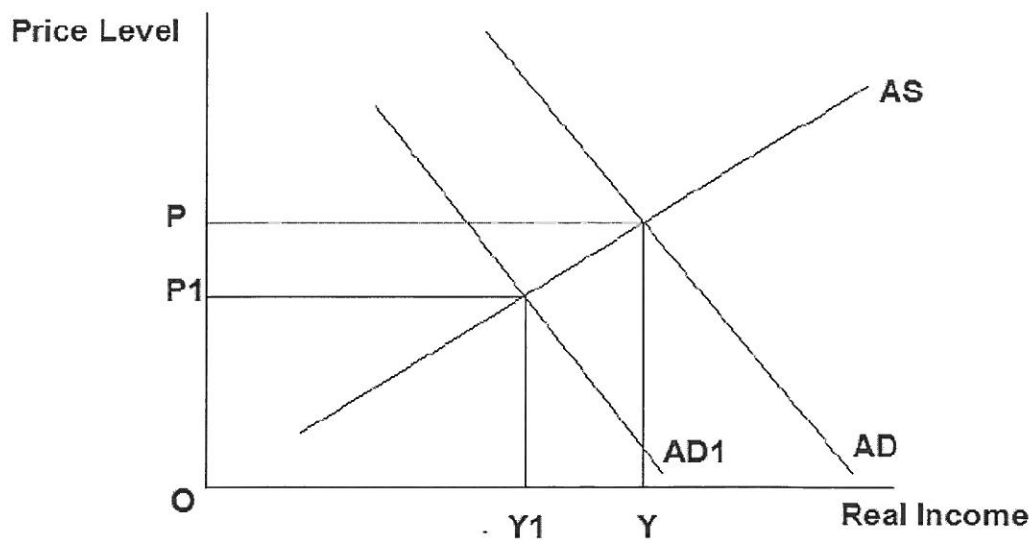


Diagram 2 assumes that a country's current account moves into deficit indicated by point A. According to economic theory, this will cause the country's exchange rate to depreciate which should in turn reestablish equilibrium at point B. This process, however, will not work quickly because the goods market does not adjust as quickly as the foreign exchange market and there will be a lag of 6-9 months before the trade flows begin to respond to the depreciation at point A. This means that for this period the country will be exporting the same volume of goods at lower prices and importing the same volume at higher prices. As a result, the deficit will get larger and the country will move to point C. This process will continue until trade flows begin to respond and the Marshall-Lerner condition becomes satisfied. Eventually, equilibrium will be restored, but much less slowly and smoothly than the theory might predict.

In contrast, the recession forces countries to cut back on spending and this has a direct impact on the consumption of imports since a certain proportion of income is spent on imports. The effect of this can be shown in diagram 3.

Diagram 3.



As AD falls to AD1, the result is that output and income fall to Y1. This will reduce imports by a corresponding amount and, as a result, the value of net exports will rise and the deficit will fall. This has clearly been observed in both the USA and Greece and by the same token China's surplus has fallen. It would thus seem that the expenditure reducing approach to deficit management is the more effective. The main cause of current account deficits is excess demand in the economy. Usually, this excess demand is generated by the Government through its budget deficit and, therefore, the best way to cure a current account deficit is to first cure the budget deficit. The Chinese are not altogether wrong in their claim that the US needs to solve its internal imbalance before blaming the exchange rate of the Chinese currency.

Source: Athens News 25th June 2012

EU Aid shows rare drop as austerity bites

Bono, co-founder of anti-poverty group ONE, discusses aid drop for Africa from EU countries

Aid flows from the European Union dropped last year for the first time in almost a decade as the eurozone crisis led 14 countries to cut financial assistance, anti-poverty group ONE said in a report published on Monday.

Overall aid from the 27 members of the EU fell 1.5 percent in 2011 to 50.86 billion euros (\$63.76 billion), the first drop since 2002, according to the report. Fourteen EU members registered a decline. Greece and Spain, both struggling to reduce gaping budget deficits, slashed aid. Germany and Italy increased their programmes, but, as with the EU as a whole, were still far short of meeting their aid commitments, ONE said.

"Huge cuts in aid from Greece and Spain are not unexpected in this time of turmoil, but the poor record further across the board is worrying," said Adrian Lovett, ONE's executive director for Europe. The advocacy group calculated that the EU would need to increase its official development assistance by 42.9 billion euros between now and 2015 to meet its targets.

For Africa, ONE's particular focus, the prospect that further budget austerity will hit aid programmes could postpone the day when countries can stand on their own feet.

While Africa needs to rely primarily on its own tax revenues to tackle poverty, outside help can increase the

governments' ability to improve tax collection, combat corruption and attract investment, which are essential to reduce poverty and stimulate development.

Such steps, the group said, would help some African economies build "the long-term conditions for when external assistance is no longer required". Some economists however, argue that countries must cut their aid dependence now, and concentrate on trade.

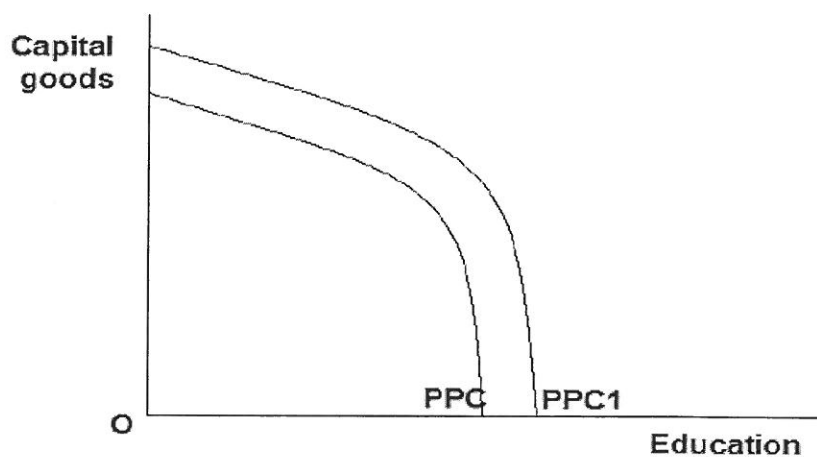
ONE calculated that the 15 countries that were EU members before 2004 needed to increase their aid to Africa over the period 2004-2015 by 26.6 billion euros to honour their public pledges. As of last year the cumulative increase had reached 6 billion euros, or just 22.5 percent of the target.

Austria, France, Germany, Greece, Italy, the Netherlands and Spain had met less than a quarter of their promised increases, while Belgium, Britain, Luxembourg and Sweden were between 50 percent and 75 percent of the way there.

With the EU about to negotiate its budget for the period 2014-2020, ONE said that it would take bold political leadership to increase foreign aid at a time of hardship at home. (Athens News)

This article looks at the issue of aid for Africa and whether it is still needed to ensure that poor countries can break out of the poverty cycle and move towards sustainable growth and development. The poverty cycle of low incomes-low savings-low investment-low productivity, is a characteristic of all less developed sub-Saharan African countries. Aid has in the past attempted to help countries to break out of this cycle by providing funds for investment that could stimulate economic growth. Alternatively, aid can be directly used for development projects such as providing primary education or health care with vaccination programs. Both investment and development projects will stimulate growth and development by increasing the quantity and quality of factors of production. The effect is shown in diagram 1.

Diagram 1

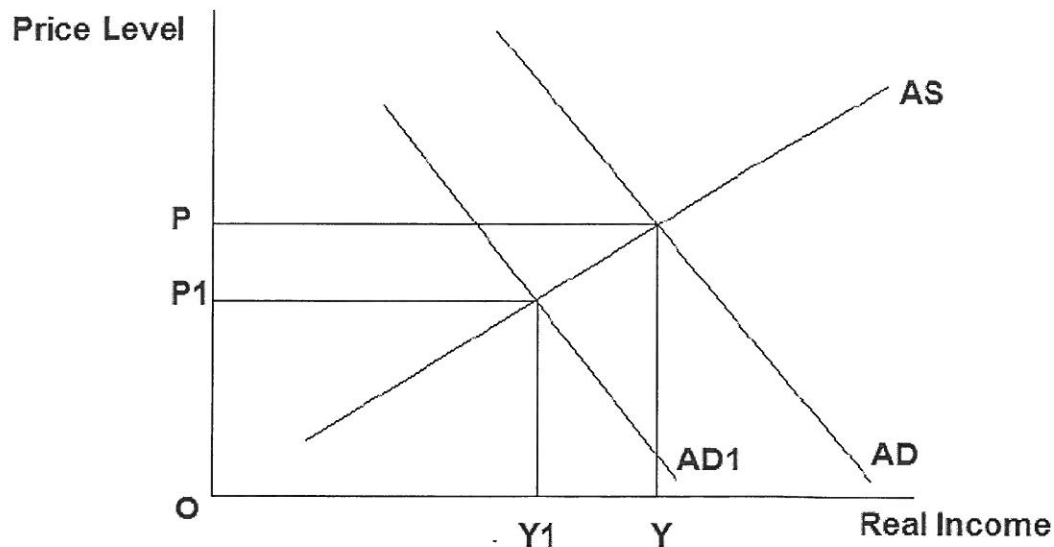


Investment increases the quantity of capital while education and healthcare increase the quality of labour, as well as, directly raising the level of development according to the Human Development Index (HDI). The result is that the PPC shifts outwards to PPC1, creating both growth and development.

The important question is whether this process can be continued if EU countries begin to cut back or aid. ONE is of the opinion that this aid shortfall will have serious consequences for many African countries, while some economists consider the reduction in aid to be beneficial as it will enable countries to reduce their dependence on aid and force them to seek growth and development through trade.

The article says that the reduction in aid is understandable given that countries are “struggling to reduce gaping budget deficits.... in this time of turmoil”. The need to reduce their deficits means that government spending has to be cut and one of the easiest cuts to make is in foreign aid. The alternative would be further reductions in domestic spending which would have a larger impact on their domestic income and employment as shown in diagram 2.

Diagram 2



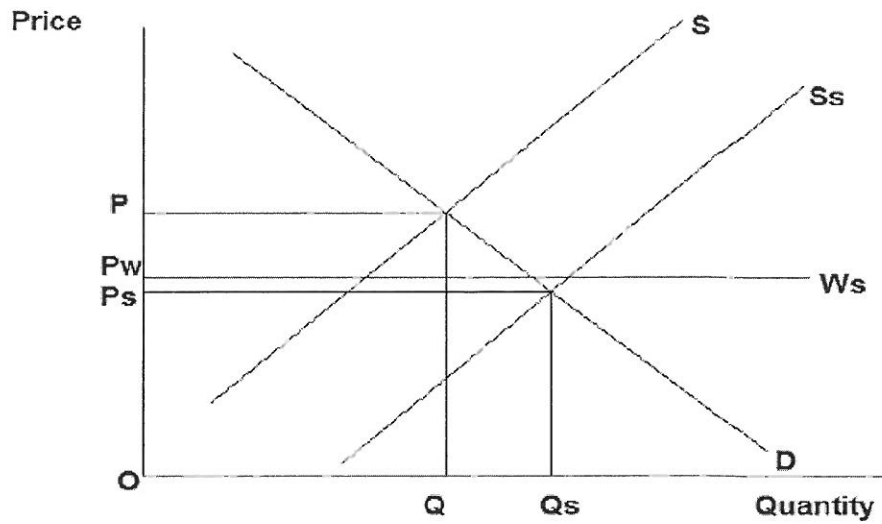
A further decrease in AD to AD1 would lead to a decrease in domestic output and employment to Y1 which would deepen the recession. Cutting aid is one way of avoiding this opportunity cost, but it is not without its own opportunity cost. One aspect of this cost is the potential increase in absolute poverty in Africa with more people struggling to survive on less than \$1.25 a day. There is also a potential long term cost because the aid would increase African incomes and this eventually would lead to increased demand for European goods which would be exports for the EU and would boost AD. This is particularly so, if the aid is tied aid or conditional on specific projects. Aid is by no means a one way process and has been an important source of reciprocity for developed countries who gain power and influence as donor countries and can often secure UN votes from the receiving countries.

It is interesting to note that over the past ten years as European countries have reduced their aid contributions to Africa, China has moved in to fill the gap with investment and infrastructure projects in return for supplies of raw materials.

The article claims that reducing aid now will prolong the time before the receiving countries can stand on their own feet, but the alternative view is that aid creates such a dependency that countries will never be able to manage without it. Reducing this aid dependence now, rather than in the future, might force the countries to face up to their problems and pursue appropriate policies for growth and development. As suggested by some economists, countries would do better to pursue trade rather than aid. However, this presupposes that they have something of value to trade and that they are allowed to trade fairly. It is well known that both the EU and the USA impose tariffs on many African goods as well as giving large farm subsidies for sugar and cotton which effectively keep African suppliers out of the market.

Diagram 3 shows how cotton subsidies give American farmers an artificial trading advantage that keeps African producers out of the market.

Diagram 3



Without the subsidy the US would not be able to export cotton because its domestic price P is above the world price W_s . With the subsidy, American producers can artificially undercut the world suppliers with price at P_s . This effectively prevents the African (world) suppliers from competing fairly in the market and shows that the 'trade not aid' argument is rather simplistic.

Resources

Sample Cover Sheets

Two coversheets are provided here. These may be adapted, as long as you include the **required** information.

- You need to provide a commentary coversheet for each of your portfolio pieces. It is advised that you adopt a common format/style for each coversheet.
- The portfolio sheet should be placed at the front of your portfolio and will be filled in at the end.
- When you submit your final portfolio, you will also have to submit an official IB form declaring that all the work is your own. Your teacher will give this to you.



Nagoya International School 003542

IB Economics – Internal Assessment Cover Sheet

Student Name:	
Candidate number:	
Source of article:	
Title of article:	
Date of article:	
URL of article:	
Date IA written:	
Word count (max 750):	
Commentary number:	
Section in syllabus:	<div><input type="checkbox"/> Section 1: Microeconomics</div> <div><input type="checkbox"/> Section 2: Macroeconomics</div> <div><input type="checkbox"/> Section 3: International economics</div> <div><input type="checkbox"/> Section 4: Development economics</div>

IB Economics – Internal assessment summary portfolio cover sheet

School code	Name of school
Candidate number	Candidate name

Commentary number	Date article published	Date commentary written	Source (each one to be different and appropriate)	Section of the syllabus the article relates to	Number of words
1.					
2.					
3.					

Checklist

The following checklist can be used to check each commentary before handing it in.

	1	2	3
Have you kept a second copy of your article and commentary for your file? Have you kept an electronic copy of the article and commentary? Have you submitted the electronic copy?			
Is there a cover sheet?			
On the cover sheet, have you noted the: <ul style="list-style-type: none"> Title of the extract? Source of the extract? Date of the extract? Word count of the commentary? Date the commentary was written? Section(s) of the syllabus to which the commentary relates? 			
Have you included the article?			
Is the commentary within the word limit (750 words)?			
Have you highlighted the relevant parts of the extract?			
Have you checked that each article is from a different source, i.e. it is not taken from the same news media as ones you have used in other commentaries?			
Have you labelled your diagrams accurately? (With relevant information from the article?)			
Are your diagrams neatly presented?			
Have you clearly explained your diagrams?			
Have you included quotations and any numerical data from the article?			
Have you used appropriate economic terminology?			
Have you attempted to provide evidence of evaluation?			
Have you made sure that you are not repeating analysis that you have done in a previous commentary?			